
Lending Risk Assessment Program

Examination Objectives

To determine the adequacy of policies, practices, procedures, and controls regarding loan portfolio management.

To determine if lending personnel are in compliance with lending policies.

To determine the overall quality of the loan portfolio and identify sources or causes of any deficiencies that have resulted or may result in greater-than-normal losses.

To determine compliance with applicable laws, rulings, and regulations.

Examination Procedures

The examination procedures of this section are intended to bring together the results of the examination programs for specific loan departments so the regulator can arrive at an overall evaluation of the entire portfolio. As such, the EIC or assisting examiner responsible for "Asset Quality" should take added precautions to avoid duplication of efforts by ensuring an exchange of information and results from each examiner responsible for the asset quality sections.

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1. Review scoping materials related to this area.

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2. Obtain and review the following:

- a. A copy of written policies and procedures covering all lending functions;
- b. Reports furnished to the board and loan committee for their meetings; and
- c. Lists of directors, officers, principal shareholders, and their interests.

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3. Review the preceding report of examination and all lending risk-related exceptions noted and determine if management has taken appropriate corrective action.
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4. Review the lending policies and any updates thereto and, as needed, abstract appropriate excerpts relative to:
- a. Distribution of loans by category;
 - b. Geographic limitations;
 - c. Industry concentration limitations;
 - d. Allowable or desirable ratios of various categories of loans to other balance sheet accounts;
 - e. Lending authorities of committees and officers;
 - f. Any prohibited types of loans;
 - g. Maximum maturities for various types of loans;
 - h. Interest-rate structure and loan pricing;
 - i. Minimum down payments for various types of loans;
 - j. Collateral appraisal policies, including persons authorized to perform appraisals and lending values of various types of property;
 - k. Financial information requirements by types of loans, especially low-doc loans;
 - l. Guidelines for purchasing loans or participations; and
 - m. Guidelines for loans to affiliated persons and organizations.
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5. Review the institution's Environmental Risk Policy. If the institution does not have a formal Environmental Risk Policy, review formal and informal controls in place to address environmental risk.
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6. In cases where more than one lending policy exists, determine that policies are internally consistent by reviewing the guidelines previously obtained.

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7. Review minutes of the loan committee meetings to obtain:
- a. Present members and their attendance record;
 - b. Scope of work performed; and
 - c. Any information deemed useful in the examination of specific loan categories or other areas of the institution.

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8. Through discussion with management, evaluate the quality of the internal loan review personnel, considering:
- a. Level of education;
 - b. Significant experience;
 - c. Availability and participation in continuing education programs;
 - d. Membership in professional organizations;
 - e. Training methods; and
 - f. Level, quality, and independence of supervision.

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9. Analyze the overall internal loan review process. Determine:
- a. Method of loan selection;
 - b. Manner in which the loan is analyzed;
 - c. Type of report generated;

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- d. Use of results by appropriate institution personnel;
- e. That procedures are in effect to monitor compliance with loan terms and loan agreements;
- f. Any possible internal restrictions placed on the review function personnel;
- g. Which internal grade classification qualifies a credit for the problem loan list; and
- h. Procedures required to remove a loan from criticized or problem loan list.

10. Request the following reports from the institution, by department, as of the examination date, unless otherwise specified:

- a. Past-due loans, including:
 - Single-payment notes 30 days or more past maturity;
 - Single-payment notes with interest due at specified intervals and demand notes on which interest is due and unpaid for 30 days or more;
 - Consumer, mortgage, or term loans, payable in regular installments, on which one installment is due and unpaid for 30 days or more; and
 - Identification of any low-doc loans included in such reports.

This report should include the following information, if possible:

- Name of the obligor
- Original amount of the loan
- Outstanding amount of the loan
- Date the loan was made
- Due date

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- Terms of the loan
- Number of payments the loan is delinquent
- Date of the borrower's last payment
- Interest billing cycle
- Date up to which interest is paid.

For large loans, the report should also include:

- Purpose of the loan
 - Any action being taken
- b. Loans in a non-accrual status;
- c. Loans on which interest is not being collected in accordance with the terms of the loan;
- d. Loans whose terms have been modified by a reduction of interest rate (other than refinanced single-family home loans) or principal payment, by a deferral of interest or principal, or by other restructuring of repayment terms;
- e. Loan participations purchased and sold;
- f. Loans sold in full since the previous examination;
- g. Loans considered problem loans by management (this report may be either as of the examination date or as submitted to the loan review committee, loan committee, or board of directors);
- h. Loan commitments and contingent liabilities (letters of credit, etc.);
- i. Extensions of credit to employees, officers, directors, principal shareholders, and their interests;
- j. Extensions of credit to officers, directors, and principal shareholders of other institutions;

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- k. Miscellaneous loan debit and credit suspense accounts;
 - l. Current interest-rate structure and loan pricing; and
 - m. Officers' current lending authority.
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11. Compare reports furnished to the board and the loan committee, and those received from the institution in step 10, to identify any material differences and to ensure that they are transmitted to the board in a timely manner.
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12. Perform the following steps for past-due loans:
- a. Compare the following to determine any material inconsistencies:
 - The past-due loan schedule in step 10.
 - Delinquency reports submitted to the board.
 - List of loans considered "problem" loans by management.
 - Delinquency lists submitted for regulatory purposes.
 - b. Scan the delinquency lists submitted to the board to determine that reports are sufficiently detailed to evaluate the risk factor.
 - c. Compile current aggregate totals of past-due loans, including overdrafts not paid in 15 days.
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13. If, between examinations, the institution has sold loans, in whole or in part, that have been criticized or that the regulator has reason to believe would be criticized if reviewed, prepare a memorandum to the regional office. The memorandum should include the following minimum information:
- a. Name and location of the institution transferring credits;

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- b. Name and location of the receiving institution;
- c. A list by name, amount, and classification (or suggested classification), of each borrowing relationship criticized;
- d. Total number and dollar amount of assets transferred;
- e. Total number and dollar amount of problem assets, together with other appropriate information;
- f. Actual or approximate date of transfer; and
- g. Any other pertinent information.

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14. Distribute the applicable schedules and other information to the regulators performing the loan examination programs.

(Note: Before proceeding to step 15, review Lending Risk Assessment Questionnaire questions 16 through 28. These questions were designed to assist the regulator in determining the extent of internal loan review and aid in its evaluation.)

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15. Obtain a list, including credit rating, of all loans reviewed since the last examination and, if available, analytical summations supporting that rating.

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16. Summarize findings, obtain management responses, and update programs and the continuing examination file (CEF) with any information that will facilitate future examinations. File exception sheets in the general file.

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17. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.
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Level II

18. Using a sampling technique, test the population of loans analyzed by the institution since the last examination to determine if problem loans are being identified. Accomplish that by reviewing internal comments on both “passed” and classified loans to determine if appropriate criteria have been considered.

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19. If it is determined that problem loans are being identified:
- a. Forward a summary, by borrower, of all loans passed by the internal loan review to the examiners responsible for the specific loan department examinations.
 - b. Instruct those examiners to determine which loans passed by the internal loan review are contained in their sample.
 - c. Request those examiners to scan the credit file for all passed loans to determine the current validity of “pass” classifications by:
 - Comparing present credit facility with that in place at the review;
 - Comparing present financial information with that used at the review;
 - Reviewing any ancillary support for the debt that was not in place at the review; and
 - Determining that no material changes have taken place in the borrower’s relationship with the bank.

If the classification is valid, do not analyze further. If the institution’s review of an individual loan is considered out of date, analyze in the normal manner.

- d. Request departmental examiners to compute the percentage of loans bearing invalid internal classifications to the total of the passed loans.

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20. Reach a conclusion regarding the scope and adequacy of the loan review function based on comparing the results from the examiner's final loan classifications to the findings of

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the loan review department, keeping in mind the timeliness of the current internal review.

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21. Determine general distribution characteristics of the loan portfolio by:
- a. Determining the percentage of total loans in specific classes.
 - b. Comparing loan category distributions with policy guidelines.
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22. Obtain the results of loan department examinations and perform the following:
- a. Determine any failure to adhere to internally established policies, practices, procedures, and controls.
 - b. Compare the various department results to determine the extent of nonadherence and if it is system-wide.
 - c. Organize the exceptions in order of relative importance.
 - d. Organize violations of laws, rulings, and regulations.
 - e. Determine the aggregate amount of classified and special mention loans.
 - f. Compile a list of all loans not supported by current and satisfactory credit information.
 - g. Compile a list of all loans not supported by complete collateral documentation.
 - h. Determine the aggregate amount of out-of-area loans, if expected to be significant.
 - i. Compute the following ratios and compare with computations from prior examinations:
 - Aggregate past-due loans to loans outstanding;
 - Aggregate classified loans to total capital;

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- Aggregate loans not supported by current and satisfactory credit information to gross loans outstanding;
- Aggregate loans not supported by complete collateral documentation to gross loans outstanding; and
- Aggregate concentrations of credit to total loans outstanding.

23. Send a "Summary of Problem Loans" to the examiner assigned to Capital Adequacy.

24. Compare management's list of problem loans from step 10 with the list of classified loans to determine the extent of managerial knowledge or recognition of their own loan problems.

25. Determine, through information previously generated, the causes of existing problems or weaknesses within the system that present potential for future problems.

26. Determine, through examiners assigned to consumer lending functions, if the institution has adhered to the board's policy in classifying "slow consumer credit" and "slow consumer credit classified as loss."

27. Send the following information to the examiner assigned to Adequacy of Valuation Allowances:

- a. A list of loans considered problem loans by management;
 - b. A list of classified loans; and
 - c. A list of rebooked charged-off loans.
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28. Summarize the overall findings relating to:
- a. The quality of internal policies, practices, procedures, and controls regarding functions;
 - b. The general level of adherence to internal policies, practices, procedures, and controls;
 - c. The scope and adequacy of the internal loan review system;
 - d. The quality of the entire loan portfolio;
 - e. The composition and trend in portfolio (identify changes that occurred or are expected to occur);
 - f. The quality of management with respect to the lending function;
 - g. Expectations for continued sound lending or correction of existing deficiencies;
 - h. Promises made by management for correction of deficiencies; and
 - i. Loans to insiders and their interests, if problems are identified.
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29. Ensure that the Objectives of this Handbook Section have been met. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on appropriate work papers and report pages.
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Examiner's Summary, Recommendations, and Comments

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